

General Information Letter: Activities described are not protected activities under Public Law 86-272.

September 19, 2007

Dear:

This is in response to your letter dated July 3, 2007, in which you request a letter ruling. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www. tax.illinois.gov](http://www.tax.illinois.gov).

In your letter you have stated the following:

We were advised by your office to request a formal nexus opinion in order to clarify the proper tax treatment for royalty income.

Company A, an out-of-state corporation, receives royalty income from Company B, an out-of-state corporation which manufactures products in a factory located in Illinois. The products produced by Company B are labeled with Company A's brand name. Company B solicits the orders, owns the inventory and ships the products to its own customers. The majority of Company B's shipments are to out-of-state customers.

Company A has no other activity in the State of Illinois other than the royalty income received from Company B. Accordingly, does the royalty income create nexus in Illinois for Company A and under what authority?

Response

The determination whether a taxpayer has nexus with Illinois is extremely fact-specific. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. For information regarding nexus, see Department of Revenue Regulations Section 100.9720 (accessible from the Department's web site). In any event, that a taxpayer has a customer located in Illinois does not reveal any particular facts about the taxpayer's activities in the state that would allow a nexus determination to be made.

In addition, the following general information may be provided.

The United States Constitution restricts a state's power to subject to income tax foreign corporations and other nonresidents. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction the state seeks to tax. (*Quill Corp. v. N. Dakota*, 504 U.S. 298 (1992)) The Commerce Clause requires that a state's tax be applied only to activities with a substantial nexus to the taxing state. (*Id.*)

As a general rule, the Department interprets the concept of nexus as broadly as possible. Where any part of a nonresident taxpayer's income is allocable to Illinois under Article 3 of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/101 *et seq.*), unless protected under P.L. 86-272, the Department will assert jurisdiction to tax.

Section 502(a) of the IITA sets forth the requirements for filing Illinois income tax returns. That section states in pertinent part as follows:

(a) In general. A return with respect to the taxes imposed by this Act shall be made by every person for any taxable year:

(1) For which such person is liable for a tax imposed by this Act, or

(2) In the case of a resident or in the case of a corporation which is qualified to do business in this State, for which such person is required to make a federal income tax return, regardless of whether such person is liable for a tax imposed by this Act.

Under this section, a nonresident must file an Illinois income tax return if it incurs a liability for tax imposed under Section 201 of the IITA, or in the case of a corporation qualified to do business in Illinois, if it is required to file a federal return (regardless of whether is liable for Illinois tax). A nonresident is liable for Illinois income tax under Section 201 if it computes "Illinois net income" as defined under IITA Section 202. IITA Section 202 defines Illinois net income as that portion of the taxpayer's "base income" as defined in Section 203, which is allocated or apportioned to Illinois under the provisions of Article 3 of the IITA, less certain deductions. The above provisions may be accessed from the Department's web site.

IITA Section 304 provides that, for taxable years ending on or after December 31, 2000, the apportionment factor for a nonresident deriving business income from Illinois and one or more other states (other than an insurance company, financial organization, or transportation company) shall be equal to its sales factor. Section 304(a)(3)(A) defines the sales factor as a fraction, the numerator of which is the total sales of the person in Illinois during the taxable year, and the denominator of which is the total sales of the person everywhere.

Section 304(a)(3) provides special rules for the treatment of royalty income in the sales factor. Section 304(a)(3)(B-2) provides:

Gross receipts from the license, sale, or other disposition of patents, copyrights, trademarks, and similar items of intangible personal property may be included in the numerator or denominator of the sales factor only if gross receipts from licenses, sales, or other disposition of such items comprise more than 50% of the taxpayer's total gross receipts included in gross income during the tax year and during each of the 2 immediately preceding tax years; provided that, when a taxpayer is a member of a unitary business group, such determination shall be made on the basis of the gross receipts of the entire unitary business group.

If Company A's royalty income is not excluded from its sales factor under this provision, Section 304(a)(3)(B-1) provides:

(i) Gross receipts from the licensing, sale, or other disposition of a patent, copyright, trademark, or similar item of intangible personal property are in this State to the extent the item is utilized in this State during the year the gross receipts are included in gross income.

(ii) Place of utilization.

(I) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If a patent is utilized in more than one state, the extent to which it is utilized in any one state shall be a fraction equal to the gross receipts of the licensee or purchaser from sales or leases of items produced, fabricated, manufactured, or processed within that state using the patent and of patented items produced within that state, divided by the total of such gross receipts for all states in which the patent is utilized.

(II) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If a copyright is utilized in more than one state, the extent to which it is utilized in any one state shall be a fraction equal to the gross receipts from sales or licenses of materials printed or published in that state divided by the total of such gross receipts for all states in which the copyright is utilized.

(III) Trademarks and other items of intangible personal property governed by this paragraph (B-1) are utilized in the state in which the commercial domicile of the licensee or purchaser is located.

(iii) If the state of utilization of an item of property governed by this paragraph (B-1) cannot be determined from the taxpayer's books and records or from the books and records of any person related to the taxpayer within the meaning of Section 267(b) of the Internal Revenue Code, 26 U.S.C. 267, the gross receipts attributable to that item shall be excluded from both the numerator and the denominator of the sales factor.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax